



**Written Comments of David Lieber
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**House Committee on Tax Policy - Hearing on HB 5004 and HB 5005
October 12, 2011**

As a significant employer in Michigan, Google appreciates the opportunity to share our concerns about HB 5004 and HB 5005, which would require out-of-state retailers to collect sales tax from Michigan residents for sales that are traceable to Michigan affiliates working in conjunction with these out-of-state retailers.

To be clear, our concerns about these bills have nothing to do with Google's sales tax liability in Michigan. Google has offices in Ann Arbor and Birmingham, and we are not seeking to avoid any sales tax collection responsibilities in our capacity as a direct seller of taxable goods or services. Indeed, nothing in these bills would modify Google's sales tax liability as a direct seller of taxable goods or services, and we are not seeking any exemption or modification to any existing tax collection responsibilities we have under Michigan law.

We are deeply concerned, however, that HB 5004 and 5005 may have the unintended consequence of depriving Michigan website publishers of significant streams of revenue. Far from promoting fairness or creating a level playing field, the bill would adversely affect Michigan-based website publishers - some of whom could be forced to leave the state - while creating no new revenue and no new jobs for Michigan. Additionally, the bill's broad language creates uncertainty for other forms of performance-based marketing, in which advertisers have shown increasing interest as they seek to harness the web's ability to measure granularly the success of advertisements and advertising campaigns.

Adverse Impact on Affiliates in Michigan

Although there is no shortage of useful content available on the Internet, many website publishers have struggled to identify consistent and sustainable sources of revenue. Google owns and operates the Google Affiliate Network (GAN), which eliminates much of the guessing work for website publishers by connecting them with advertisers who are interested in marketing their products and services to new audiences. GAN essentially serves as a matchmaker for both advertisers and website

publishers that are interested in affiliate relationships but may lack the time, resources, or wherewithal to effectively manage such a program.

GAN enables website publishers who are interested in earning revenue to easily drive leads to advertisers and earn commissions based on leads that result in sales. For example, a Michigan resident that maintains a well-followed blog about consumer electronics (i.e. a website publisher) can monetize her content by contracting with a national retailer of consumer electronics (i.e. an advertiser), earning revenue that enables that resident to build or maintain a small business in Michigan. In many instances, this contractual relationship is fairly simple; the website publisher places a link to the advertiser's website (or a link to a specific page on the advertiser's website) and is compensated when users complete transactions on the advertiser's website.

It is important to note what this bill won't do in addition to what it will do. The vast majority of online sales are not facilitated by affiliate networks or affiliate programs. HB 5004 and 5005 - if enacted - will thus have no bearing on the vast majority of sales that occur online. The bill does not impose a general obligation on out-of-state retailers to collect sales taxes for in-state purchases; it only does so when a Michigan resident directly or indirectly refers Michigan-based sales to out-of-state retailers in the manner set forth by the bills.

The unintended consequences of affiliate tax laws are tangible. In Arkansas, Illinois, North Carolina and Rhode Island, advertisers cancelled their affiliate programs in response to affiliate tax laws, depriving fledgling businesses in those states of significant sources of revenue. In Illinois, at least two Illinois affiliates that employ approximately 100 people in high-paying jobs moved their businesses to different states.

Revenues from affiliate marketing are often the lifeblood for many Internet entrepreneurs, who depend on the commissions they receive from advertisers for their livelihoods. HB 5004 and 5005 would deprive Michigan businesses of these important streams of revenue without providing any tangible benefits to retailers in Michigan.

Affiliate Tax Highly Unlikely to be New Source of Revenue for Michigan

For the very small percentage of online transactions that HB 5004 and 5005 theoretically encompass, the practical impact will be negligible. In response to affiliate tax laws in other states, many advertisers have rescinded affiliate programs rather than grapple with the challenges associated with tax collection in those states. Although there is software that is available to manage tax collection in the thousands of tax jurisdictions throughout the United States, the software itself is not a panacea.

Taxing jurisdictions often increase or decrease taxes associated with covered goods and services, expand or contract the universe of goods and services subject to sales tax, and issue regulatory guidance that interprets existing sales tax laws and regulations to cover new and/or specific categories of goods and services. Even the best software is not infallible in its capacity to capture comprehensively the various actions undertaken by taxing jurisdictions in real-time. Moreover, there are risks in relying too heavily on such software for tax compliance; both the failure to collect enough sales tax and the collection of too much sales tax create regulatory and legal risks.

In all likelihood, few online retailers will collect sales tax for the small percentage of online sales that are subject to the affiliate tax. Indeed, this is borne out by the experiences of states that have codified affiliate tax laws.

In New York, Amazon is challenging the constitutionality of the state's affiliate tax law. Although Amazon is collecting sales tax for New York affiliate sales in order to maintain standing, the new revenue stream created by the law will prove illusory if the law is overturned.

In North Carolina, the Department of Revenue has failed to respond to a May 2010 freedom of information request seeking information about the revenue it has received as a result of the state's enactment of an affiliate tax. There is thus no reliable data concerning the amount of revenue (if any at all) that has been generated by the North Carolina affiliate tax law.

In Rhode Island, the state's former General Treasurer, Frank Caprio, asserted (while General Treasurer) that the "affiliate tax has hurt Rhode Island businesses and stifled their growth, as they've been shut out of some of the world's largest marketplaces, and [it] should be repealed immediately." The Rhode Island Department of Revenue has acknowledged that no sales tax revenue has been collected as a result of the new affiliate tax.

Unintended Consequences for Performance-Based Marketing

HB 5004 and 5005 threaten to imperil the viability of new and innovative advertising models that marshal the unique capabilities of the web. Unlike many offline advertising platforms, the Internet enables advertisers to measure the success of advertising campaigns and even compensate advertising networks based on the success of those campaigns.

Typically, online advertising networks are compensated when a user clicks on an advertisement. Compensating advertising networks on a cost-per-click (CPC) basis is a

form of performance-based marketing. Under this scenario, advertisers do not compensate advertising networks like Google when an advertisement is served. Rather, a user must affirmatively click on the advertisement before any consideration is paid.

Increasingly, advertisers are experimenting with new forms of performance-based marketing, including compensation arrangements where advertising networks are remunerated only when a user clicks on an advertisement and subsequently purchases a product or service. This form of advertising is often referred to as cost-per-acquisition (CPA).

As drafted, HB 5004 and 5005 would have the seemingly unintended consequence of potentially imputing nexus to an out-of-state advertiser by virtue of their advertising relationship with an in-state advertising network. CPA advertising continues to be a burgeoning area of growth for Michigan and other states that can benefit the entire Internet advertising ecosystem, including advertising networks, advertisers, and website operators.

Earlier this year, California addressed the CPA issue when it passed affiliate tax legislation. Should it decide to further consider HB 5004 and HB 5005, this Committee should consider amendments to narrow the scope of the bills and avoid unintended consequences that would create regulatory uncertainty for the broader Internet advertising industry. We would happy to discuss potential amendments with the sponsors of HB 5004 and HB 5005 in order to avoid any unintended consequences.

For all of these reasons, we respectfully oppose HB 5004 and HB 5005. Thank you for your time and consideration of our views.